TECHNICAL, INDUSTRIAL

AND

COMMERCIAL EDUCATION

IN FRANCE

BY

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MONETARY POLICY

BEING THE REPORT OF A SUB-COMMITTEE

ON

CURRENCY AND THE GOLD STANDARD

APPOINTED BY THE RESEARCH COMMITTEE OF THE BRITISH ASSOCIATION FOR THE ADVANCEMENT OF SCIENCE ON THE EFFECTS OF THE WAR ON CREDIT, CURRENCY, FINANCE AND THE FOREIGN EXCHANGES, NOW REPRODUCED, WITH MINOR ALTERATIONS BY THE INDIVIDUAL MEMBERS OF THE SUB-COMMITTEE

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PREFACE

Early in 1920 the Research Committee on the *Effects of the War on Credit, Currency, Finance and the Foreign Exchanges* of the British Association for the Advancement of Science appointed a sub-committee to deal with the subject of *Currency and the Gold Standard* The members of the sub-committee—Dr J H Clapham, C W Guillebaud, F Lavington and D H Robertson—duly presented their report to a meeting of the Section at the recent gathering of the Association at Edinburgh in September last

One of the disadvantages of a joint production of this kind is that the result can represent only, as it were, the H C F of agreement among its authors It cannot reflect the views of any one of them with either the exactness or the vigour he would wish In this case the only appreciable discrepancy of the kind lies in the importance which we individually assign to the re-establishment of an effective gold standard Dr. Clapham, together with Mr Guillebaud who wrote Part I, and Mr Lavington who wrote Part II, attach rather more importance to a return to a gold standard than is given by Mr. Robertson, to whom it fell to discuss this particular question

in Part III Mr Robertson's views, which are hardly given full vent in this last Part, are discussed more adequately in his forthcoming volume on *Money*, in the Cambridge Economic Series (Nisbet) We have not felt, however, that the fact of our discussions ending in compromise need prevent our joint signature, because we believe that the statement of the considerations on which a judgment of currency policy may be formed is of more importance and of more general interest than the shade of emphasis which the writers may lay on their conclusion

In view of the active public interest which is now being shown in currency policy and of the necessarily limited publicity which a brief discussion before the Association could give to a report of this kind, we have, rightly or wrongly, thought it worth while to reproduce the report and, with a few minor changes in its wording, to publish it independently under the title *Monetary Policy*

J H C.
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CAMBRIDGE,
October, 1921

MONETARY POLICY

This discussion of current monetary policy deals with the effects of the war on the currency of the United Kingdom and with the alternative policies which may be adopted to meet the difficulties of the present situation Its subject matter has been divided into three parts

Part I contains a review of the more important statistical information bearing on the expansion of the currency and the National Debt, the changes in the level of prices and in the volume of foreign trade during the period 1913–1921 Its principal tables are

1. The accounts of the Bank of England (pp 9–11)

2 The combined accounts of the Joint Stock banks of the United Kingdom (pp. 12–22)

3. The issues of Bank of England and Currency Notes (pp 22–25).

4 The National Debt (p. 26).

5 The balance of foreign trade (pp. 26–33), and

6. The level of wholesale prices (pp. 33–35).

Part II, based on this statistical groundwork, discusses the effects of a higher or lower level

of prices on the general social well-being with a view to determining whether it would be in the interests of this country that prices should be higher or lower than that post-war level which, in the absence of deliberate action, may be expected to establish itself

Part III, continuing this argument, takes into account the desirability of returning to an effective gold standard and considers what are our prospects of doing so in the near future

Part I

STATISTICAL INFORMATION

§ 1 The Bank of England

The position of the Bank of England since August, 1913, is shown in the following tables Comparing the Weekly Return dated June 1, 1921, with the one dated July 22, 1914, the changes in the various items making up the return are as follows

Issue Department

At	Notes Issued £m	Total £m	Government Debt £m	Other Securities £m	Gold Coin Bullion £m	Total £m
July 22, 1914	57 0	57 0	11 0	7 4	38 6	57 0
Aug 5, 1914	44 5	44 5	11 0	7 4	26 0	44 5
,, 4, 1915	79 7	79 7	11 0	7 4	61 2	79 7
,, 2, 1916	71 4	71 4	11 0	7 4	52 9	71 4
,, 1, 1917	68 3	68 3	11 0	7 4	49 8	68 3
July 31, 1918	85 0	85 0	11 0	7 4	66 6	85 0
,, 30, 1919	104 7	104 7	11 0	7 4	86 2	104 7
,, 28, 1920	139 9	139 9	11 0	7 4	121 5	139 9
June 1, 1921	145 0	145 0	11 0	7 4	126 5	145 0
Increase since July 22, 1914	88 0	88 0	Nil	Nil	88 0	88 0

BANKING DEPARTMENT

At	Proprietors' Capital £m	Rest £m	Public Deposits £m	Other Deposits £m	7-Day or other Bills £m	Total £m
July 22, 1914	14 6	3 4	13 7	42 2	0 015	73 9
Aug 5, 1914	14 6	3 5	11 5	56 8	0 010	86 4
,, 4, 1915	14 6	3 5	147 1	84 2	0 041	249 3
,, 2, 1916	14 6	3 4	51 0	85 5	0 032	154 5
,, 1, 1917	14 6	3 3	44 8	128 7	0 016	191 5
July 31, 1918	14 6	3 4	37 8	138 4	0 010	194 2
,, 30, 1919	14 6	3 4	17 9	116 6	0 014	152 4
,, 29, 1920	14 6	3 3	15 1	118 7	0 014	151 7
June 1, 1921	14 6	3 2	10 6	133 2	0 009	167 5
Increase since July 22, 1914	Nil	(decrease) 0 2	2 9	91 0	(decrease) 0 006	93 6

BANKING DEPARTMENT—*continued*

At	Government Securities £m	Other Securities £m	Notes £m	Gold and Silver Coin £m	Total £m
July 22, 1914	11 0	33 6	27 7	1 6	73 9
Aug 5, 1914	11 0	65 4	8 4	1 6	86 4
,, 4, 1915	46 9	155 3	46 2	1 0	249 3
,, 2, 1916	42 2	75 7	34 7	2 0	154 5
,, 1, 1917	54 4	110 7	27 8	2 6	191 5
July 31, 1918 .	58 6	106 8	28 1	0 7	194 2
,, 30, 1919	43 1	81·7	25 3	2 2	152 4
,, 29, 1920	59 9	75 5	14 6	1 8	151 7
June 1, 1921	68 6	81 3	15 9	1 8	167 5
Increase since July 22, 1914	57 6	47·7	(decrease) 11 8	0 2	93 6

As is pointed out below, much of the increase in the note issue has gone into the reserves of the Joint Stock banks to replace gold formerly held there

The increase in the holdings of Government Securities has been considerable during the last two years, and the total increase since July, 1914, of Securities held—£1[illegible]5 m.—indicates the extent to which circumstances have compelled the Bank of England to co-operate in the general expansion of credit

Changes in the Bank rate have had an important effect upon business and prices during the period under review, for this reason a table is appended showing the changes in the Bank rate since the outbreak of the war

Date	Per cent
July 30, 1914	4
July 31, 1914	8
August 1, 1914	10
August 6, 1914	6
August 8, 1914	5
July 13, 1916	6
July 18, 1917	5½
April 5, 1919	5
November 6, 1919	6
April 15, 1920	7
April 28, 1921	6½
June 23, 1921	6
July 21, 1921	5½

Assets

	1913		1918		1919		1920	
	£m	Per cent of Total	£m	Per cent of Total	£m	Per cent of Total	£m	Per cent of Total
Cash in Hand and at Bank of England	152.3	11.9	354.1	15.5	443.5	16.0	440.7	15.3
Money at Call and Short Notice	145.6	11.4	275.6	12.0	150.1	5.5	153.1	5.3
Investments	210.9	16.6	510.6	22.3	600.0	21.7	552.7	19.1
Bills Discounted	168.4	13.2	460.8	20.1	364.7	13.2	415.9	14.4
Advances	505.8	39.7	598.1	26.1	1,018.5	36.8	1,182.8	40.9
Liability of Customers for Acceptances	63.5	5.0	65.1	2.8	161.1	5.8	112.5	3.9
Bank Premises, etc	27.5	2.2	27.9	1.2	28.1	1.0	31.4	1.1
Total Assets	1,274.0	100.0	2,292.1	100.0	2,767.1	100.0	2,889.1	100.0

(*a*) Increase since 1913 in Deposit Liabilities to Customers—£1,479 m.

The Deposit Liabilities at the end of 1920 were roughly 2½ times the pre-war amount Out of the total increase of £1,479 m as much as £517 m., or approximately 35 per cent of the total, was created during the two years 1919 and 1920 The year 1919, with an increase of £365 m, saw the greatest absolute increase of any year since the commencement of the war. The causes of this great expansion are not far to seek They are due chiefly to (*a*) Government expenditure, (*b*) requirements for manufacturing and trading

purposes, including credits granted by manufacturers and traders to foreign customers.

(*a*) The Government apparently feared that a very serious slump would come soon after the cessation of hostilities as a result of the turnover from war to peace conditions It therefore made no attempt for months after the Armistice to hasten the reduction of administrative expenditure, demobilization was slowed down, large gratuities were given to the demobilized, and high rates of out-of-work pay to men discharged from the Services Although an attempt was made to fund part of the floating debt by means of the Victory Loan, the operation was not attended by much success The banks were urged to subscribe, and did, in fact, take up as much as £111 m of the loan, a fact which explains part of the above-mentioned increase of £365 m during 1919 (*b*) The tremendous stimulus of victory, the relaxation of Government controls after the Armistice, and the sudden demand both at home and abroad for innumerable things of which the peoples of all countries had been deprived during the war, led to a period of extraordinary industrial and commercial prosperity. Raw materials increased very rapidly in price, and overdrafts had to be augmented in order to finance raw material purchased at these swollen prices The demand for credit was unlimited, while the inflated stock values formed the security on the basis of which further credits were granted The Bank rate was kept at the relatively very

low figure of five per cent. till November, 1919, when it was raised to six per cent In order to have checked the excessive over-trading during the latter part of 1919 and the first four months of 1920, it would have been necessary to raise the rate of discount far higher and for the Bank of England to have taken steps to make that rate effective

Early in 1920 the Treasury and the Bank of England, becoming seriously alarmed at the rate of credit expansion, took active steps to check further inflation A limit of £320 m was set at the end of 1919 to the fiduciary issue of currency notes The Bank rate was raised in April, 1920, to 7 per cent , and the banks set themselves to scrutinize very carefully new demands for credit and to reduce, if possible, some of the existing advances At the same time a variety of causes connected partly with the state of trade in the Far East and in America, partly with the temporary satiation of the post-war demand for goods in this country and on the Continent, and partly with the general revolt of consumers against the rise in retail prices, had combined to put an end to the prosperity which trade and industry had been enjoying since the Armistice. The demand for goods fell off and prices slumped heavily during the second half of 1920 In view of these facts, it is a little surprising to find that at the end of 1920 deposits were £150 m , and advances to customers £164 m., higher than at the end of 1919.

A great deal of this increase is no doubt accounted for by the growth during the first four months of 1920, when expansion was proceeding unchecked. Assuming that the rate of expansion was the same during this period as during the whole of 1919 an additional £120 m of deposits and £140 m of advances can be attributed to that period alone

It is difficult to discover what was the precise policy of the banks in regard to advances, etc., during the latter part of 1920 On every hand complaints were made by manufacturers that their credits were being restricted and called in, and that in consequence they were finding the utmost difficulty in financing their business It is clear that despite all their endeavours the banks were unable during this period to reduce the absolute amount of advances, etc , outstanding , the utmost that they could do was to stop further expansion Many firms were compelled to get assistance from the banks in order to pay Excess Profits Duty owing on previous years' trading, and there can be no doubt that at a time when a very large proportion of the resources of most firms was locked up in stocks, the value of which was rapidly falling, any attempt to call in loans on an extensive scale would have resulted in widespread bankruptcy A further cause of the maintenance of the very high level of deposits was the large amount of long term credits to foreign firms, which the exceptional conditions of the period made it impossible to call in.

Judging from a comparison of the average balance sheets of the five great Joint Stock banks for May, 1921, with the corresponding figures for December 31, 1920, there has at last been a slight reversal of the tendency for deposits and advances to increase At the end of December, 1920, the combined deposits of the "Big Five" amounted to £1,628 m while the advances were £768 m At the end of May, 1921, the corresponding figures were deposits, £1,579 m, advances, £763 m There was thus a decrease of approximately £50 m in deposits and of £5 m. in advances since the end of last year

The annual increase since December 31, 1913, of the deposits of all the Joint Stock banks of the United Kingdom (except the Bank of England) is shown in the following table

At December 31	Amount £m	Increase £m
1913	1,070·7	—
1914	1,167·3	96·6
1915	1,271·7	104·4
1916	1,478·8	207·1
1917	1,742·9	264·1
1918	2,033·5	290·6
1919	2,398·8	365·3
1920	2,549·3	150·5
Increase over 1913		1,478·6

(*b*) Increase since 1913 in Cash in Hand and at Bank of England—£288 m.

It will be noted from the following table that the chief increases took place in 1916 and 1919, and that in each case the succeeding year showed a decrease, corresponding to a change in the method of Government borrowings.

CASH RESERVES.

At December 31	Amount £m	Increase £m
1913	152 3	—
1914	221·6	69 3
1915	224 4	2 8
1916	337·3	112·9
1917	319·5	17·8 (decrease)
1918	354·1	34·6
1919	443·5	89·5
1920	440 7	2 8 (decrease)
Net increase over 1913		288·4

(*c*) Increase in Money at Call and Short Notice—£7·5 m.

The amount of Money at Call and Short Notice increased rapidly after 1915, until it reached its high-water mark in 1918. In 1919, as will be seen from the following table, there was a very large decrease in this item. This was probably due in

the main to the extra demands made by Industry, and to the credits extended to customers to buy Funding Stock as explained above.

MONEY AT CALL AND SHORT NOTICE

At December 31	Amount £m	Increase £m
1913	145 6	—
1914	122 2	23 4 (decrease)
1915	101 5	20 7 (decrease)
1916	121 7	20 2
1917	214 9	93 2
1918	275 6	50 7
1919	150 6	125 0 (decrease)
1920	153 1	2 5
Total net increase over 1913		7 5

(*d*) Increase in Investments over 1913—£342 m.

While the value of many of the existing securities held by the banks has suffered heavy depreciation as a result of the rise in the general level of interest during the war, the banks have invested very large sums in the various War loans, estimated at £400 m. by the end of 1919. The further fall in the value of securities during 1920 no doubt accounts largely for the decline of £47 m. during this year.

INVESTMENTS

At December 31	Amount £m	Increase £m
1913	210 9	—
1914	241 7	30 8
1915	441 1	199 3
1916	436 7	4 4 (decrease)
1917	432 0	4 7
1918	510 6	78 6
1919	600 0	89 5
1920 .	552 7	47 4 (decrease)
Total net increase over 1913 .		342 0

(c) Increase in Bills Discounted since 1913 —£247 m.

The amount of Bills Discounted reached its highest level during 1918 In 1919 there was a decrease of £96 m , owing mainly to the non-renewal of maturing Treasury Bills, resources being required for financing business during the boom period. With the slump in trade in 1920 and the raising of the Treasury Bill rate from 5½ per cent. to 6½ per cent. in April, 1920, the volume of Bills Discounted increased again by £51 m. over the preceding year It is, however, especially unsafe to draw inferences from these figures, inasmuch as the banks have not all included their Treasury Bills under the heading Bills Discounted, and some of them have altered

their practice in this respect during the period covered by these figures

The movements since 1913 are shown in the following table —

BILLS DISCOUNTED

At December 31	Amount £m	Increase £m
1913	168.4	—
1914	161.5	6.9 (decrease)
1915	127.4	34.1 (decrease)
1916	176.2	48.8
1917	368.0	191.9
1918	460.8	92.7
1919	364.7	96.1 (decrease)
1920	415.9	51.2
Total net increase over 1913		247.5

(*f*) Increase in Advances since 1913—£677 m.

During the war Advances increased by only a very small extent, but with the cessation of hostilities and the freeing of trade they grew with extraordinary rapidity from £598 m. at the end of 1918 to £1,018 m. at the end of 1919. It has already been pointed out, in dealing with the increase in deposits, that the requirements of trade to finance very large stocks in a falling

market remained very great, and the figures show, in fact, a further increase at the end of 1920 of £164 m. over 1919.

ADVANCES

At December 31	Amount £m	Increase £m
1913	505 8	
1914	536 3	30 5
1915	498 3	38·0 (decrease)
1916	533 5	35 2
1917	549 1	15 6
1918	598 1	49 0
1919	1,018·5	420 4
1920	1,182 8	164 3
Total net increase over 1913		677 0

§ 3 CURRENCY.

From the end of July, 1914, there was a continuous expansion of paper currency uncovered by gold up to the end of December, 1920, when total currency notes and certificates outstanding amounted to £367·7 m. against which there was a reserve of gold of £28·5 m. and of Bank of England notes of £19 5 m.

During the first half of 1921 there has been an appreciable decrease in the currency note circulation. The figures are set out in the following table.

CURRENCY NOTES.

At	Notes and Certificates Outstanding £m	Gold Coin and Bullion £m	Bank of England Notes £m	Ratio to Notes, per cent	Government Securities £m	Balance at Bank £m
Aug 4, 1915	46·7	28·5	—	61·0	9·6	7·4
„ 2, 1916	127·7	28·5	—	22·4	92·7	8·6
„ 1, 1917	168·5	28·5	—	16·9	141·6	5·2
July 31, 1918	263·3	28·5	—	10·8	240·4	5·7
„ 30, 1919	338·8	28·5	—	8·4	323·3	3·3
„ 28, 1920	355·1	28·5	18·5	13·2	331·5	0·3
June 2, 1921	331·0 (including £2 m notes called in but not yet cancelled)	31·5 (including £3 m silver)	19·5	14·5	295·6	0·2

It should be noted that the great increase of prices which took place between July, 1919, and July, 1920, cannot be attributed in any appreciable degree to an increase in the currency note circulation during the same period, for this increased by only £16 m., from £339 m. in July, 1919, to £355 m. in July, 1920.

The most important step taken after the war with regard to the currency note issue was the decision set out in the Treasury Minute of November, 1919, to limit the total fiduciary issue of currency notes in any year, i.e. the issue in excess of gold, silver, and Bank of England notes held in the currency notes redemption account, to the maximum actual fiduciary issue in the preceding year. For 1920 this limit was £320·6 m.

In order to maintain this limit, Bank of England notes were transferred from the Bank's reserve to the currency note redemption account as further increases were made in the currency note issue In October, 1919, £1 4 m. in Bank of England notes was transferred, and this was rapidly increased to £18 5 m in July, 1920. The amount of Bank of England notes at present in the currency note redemption account is £19 5 m, while the maximum fiduciary issue for 1921 has become £317 6 m

	December 23, 1919 £m	December 22, 1920 £m	June 1, 1921 £m
Bank of England Notes in Circulation	92 2	134 6	145 0
Currency Notes in Circulation .	358 2	365 5	331 0
Total Circulation	450 4	500 1	476 0
Less Bank Notes in Currency Notes Reserve	4 0	19 5	19 5
Net Note Circulation	446 4	480·6	456 5
Gold in Bank of England	91 3	127 8	128 4
Gold in Currency Notes Reserve	28 5	28 5	28 5
Total Gold Reserves . .	119 8	156 3	156 9
Proportion Gold to Notes . .	26·8%	32·5%	34·4%

The actual position of the total net note circulation can be seen from the preceding table.[1]

A large part of the increase in the Bank of England gold reserve between December, 1919, and December, 1920, probably as much as £30 m., was drawn from the reserves of the Joint Stock banks, and was replaced in their vaults by Bank of England notes. Hence most of the increase in the Bank of England notes during 1920 went into reserve and did not result in an increase of currency in the hands of the public.

This policy of concentrating all the available gold reserves in the Bank of England, which was recommended by the Committee on Currency in 1919 in order to strengthen the basis of the note issue, was put into effect in 1920.

It is important not to overlook the fact that the total increase of about £450 m. in the circulation of bank and currency notes between 1913 and 1920 is attributable in part to the replacement of the gold coin which was in circulation in 1913. It has been estimated that about £120 m. of the additional note issue must be regarded as a substitute for coin formerly in circulation or in the reserves of the Joint Stock banks.

[1] The total volume of Scotch and Irish notes outstanding on December 31, 1920, amounted to £64 m. These notes are largely covered by holdings of currency notes and are therefore not included in the above table.

§ 4. NATIONAL INDEBTEDNESS.

The growth of national indebtedness during and since the war is an important factor in the general credit and currency situation, and it has therefore been thought advisable to show the change which has taken place since 1913.

Financial Year ending March 31	Funded Debt	Unfunded Debt	Treasury Bills included in Column 2	Other Capital Liabilities, including Terminable Annuities	Aggregate Gross Liabilities of the State
	£m	£m	£m	£m	£m
1913 . .	593	37	Small	86	716
1914	587	35	Small	86	708
1915	583	497	86	85	1,166
1916 .	318	1,796	574	83	2,197
1917 .	318	3,670	464	76	4,064
1918	318	5,532	973	71	5,921
1919	318	7,096	957	67	7,481
1920 .	315	7,451	1,102	56	7,832
1921	315	7,262	1,121	67	7,644

It will be noted that for the year ending March 31, 1921, there is a reduction in total liabilities of £188 m

Out of the total Unfunded Debt on March 31, 1921, £1,162 m. was in respect of debt owing to foreign countries—a decrease as compared with March 31, 1920, of £117 m.

§ 5. FOREIGN EXCHANGES AND THE BALANCE OF TRADE.

During the war and for several months after the Armistice, the rates of exchange between

England and the United States and between England and many of the European countries were artificial and did not correspond with the relative price levels or with the balance of trade It was not until March, 1919, that the London-New York exchange was unpegged, and it took some time before rates found their natural level The exchange which in March, 1919, stood at \$4 76½ to the £1 fell by the end of December, 1919, to \$4 0, and in February, 1920, touched as low as \$3 195 It recovered to a certain extent during the following months, and stood at the end of 1920 at \$3 540. During the early months of 1921 there was a considerable appreciation in the dollar value of sterling, which rose to \$4 01 on May 20, only to decline by the end of the month to \$3·88

As the United States is still on the gold standard, the rate of exchange between the dollar and the £ sterling is a convenient measure of the distance which still separates us from a return to gold parity.

Another measure can be obtained from the premium which gold in the English market commands over the price paid by the Mint—77*s.* 10·5*d.* per standard oz., or 84*s.* 11·45*d* per fine ounce. The price of gold *per fine ounce* has been quoted daily since September 22, 1919. The average price during 1920 was 112*s.* 11·52*d.* (33 2 per cent. premium), while the highest price touched was 127*s.* 4*d.* (50·1 per cent. premium) on February 5, 1920, and the lowest 102*s.* 7*d.*

(20·9 per cent. premium) on April 9, 1920 The price of gold naturally follows closely the fluctuations in the exchange on New York. At the end of 1919 when the exchange was $3 54, the price of gold was 116*s* 1*d* , on May 20, when the exchange had risen to $4 0, the price of gold fell to 102*s*. 8*d*., and rose at the end of May to 106*s* 4*d* , while the exchange fell to $3 88

The movements of the New York exchange, especially during the latter part of 1919, and the first six months of 1920, should be regarded as reflecting the general business relations, not between the United States and Great Britain alone, but between the United States and Europe. This country was financing through business credits a large part of Continental purchases in the U S A with the result that, while the British balance of trade was improving, the rates of exchange were moving against this country. Although the granting of new credits to the Continent by Great Britain was checked during the latter part of 1920, the volume outstanding must still be very great, and, as the loans to the Continent are for the most part for relatively long terms, while many of the American business credits are for short terms, the existence of this indebtedness will continue to exert a depressing influence on the rate of exchange.

The improvement in the total balance of trade can be seen from the following table :—

FOREIGN TRADE OF U K

	1919 £m	1920 £m	Increase or Decrease in 1920 £m	Increase or Decrease in 1920 per cent
Imports	1,626 2	1,936 7	+ 310 6	+ 19 1
British Exports	798 6	1,335·6	+ 536 9	+ 69 1
Re-exports . .	164 7	222 4	+ 57·7	+ 34·9
Total Exports	963 4	1,558 0	+ 594 6	+ 61 8
Excess of Imports over Total Exports .	662 8	378 8	— 284 0	— 42 6

An attempt has recently been made in the *Board of Trade Journal* to estimate the value of invisible exports from this country in 1920. The estimate was necessarily a very rough one.

	£ m.
It suggested that the *net* income from shipping in 1920 was . . .	340
The income from investments abroad .	120
The income from banking and insurance .	40
Total income from above sources . .	£500
Against this must be set the excess of imports of merchandise over exports, amounting to	379
Less excess exports of coin and bullion .	44
Resulting in a net excess of visible imports of	£335

Hence there was possibly an excess of exports, visible and invisible, over visible imports, of some £165 m.

	(Million £)		
	Value recorded in 1920	Value at 1913 Prices	Value recorded in 1913
Imports			
Food and Drink	767·4	266·4	295·1
Raw Materials .	711·5	245·8	269·9
Manufactures .	454·8	161·7	201·0
Total Imports (inc. misc.)	1,936·7	675·0	768·7
Exports			
Food and Drink	50·9	18·2	33·9
Raw Material .	145·7	32·2	66·2
Manufactures .	1,120·7	303·6	413·8
Total (inc. misc.) .	1,335·6	359·2	525·3
Re-exports			
Food and Drink . . .	46·1	23·2	16·3
Raw Materials . . .	123·0	52·9	63·7
Manufactures . . .	53·2	21·5	29·5
Total Re-exports .	222·4	97·2 (*sic*)	109·6
Total Exports . . .	1,558·0	456·4	634·9

In considering the movements of foreign trade it must not be overlooked that price changes veil to a great extent the changes in the actual volume of goods. The significance of the above-

mentioned improvement in the balance of trade in connexion with the prospects of a return to a gold standard is weakened by the fact that, as is shown by the preceding table taken from the *Economist*, the increase in the prices of our exports during the past year was much greater than the increase in the prices of our imports With the disappearance of the causes which temporarily enable very high prices to be obtained for British exports, the balance of trade is likely to become less favourable.

As compared with 1919 the total exports (recorded values) increased in 1920 by 62 per cent., but the increase in actual volume, taking both years at 1913 prices, was not more than 29 per cent.

Comparative figures of this kind, showing changes in the volume and value of our foreign trade, are of special significance in connexion with the subject matter of this report On the one hand, changes in the volume of trade form a measure, though a rough and imperfect one, of the decline in the national output. On the other, the fact that the prices of the goods we export have risen more than the prices of the goods we import shows how this decline in the real output of the nation is partially compensated by the effects of peculiarly favourable conditions of international trade—conditions which can hardly be other than temporary. For this reason, further figures are given showing the condition of our foreign trade during the first quarter of 1921, a period of marked trade depression which

terminated, it will be remembered, before the occurrence of the dispute in the coal trade.

[1] Figures published by the Board of Trade show that if the goods exported and imported during the first quarter of the current year are assigned the average values recorded for the first quarter of 1913 —

(*a*) the *volume* of our imports for the quarter was 71 per cent of the volume in the first quarter of 1913,

(*b*) the *volume* of our exports for the quarter was 53½ per cent of the volume in the first quarter of 1913, and

(*c*) the volume of our re-exports for the quarter was 55 per cent of the volume in the first quarter of 1913

These figures suggest, though they are far from proving, that the national output in the first quarter of 1921 was substantially less than three-quarters of that reached in the corresponding quarter of 1913. But the injury to the real national income arising from this decline in productivity is modified by the fact that each unit of exported goods exchanged for a larger quantity of imported goods than in 1913. The substantial, if only temporary, advantage which we obtained from this favourable condition of trade is shown by the facts that, comparing as before the first quarters of 1921 and 1913 —

[1] Vide *Journal of the Royal Statistical Society*, May, 1921.

(*a*) the average values of our imports advanced 120 per cent.,

(*b*) the average values of our exports advanced 234 per cent, though

(*c*) the average values of our re-exports advanced less than those of our imports

§ 6. Commodity Prices

The combined effects of increases in the volume of purchasing power and of shortage of goods, as set out in the preceding sections, caused a rise in the price level during and after the war which was continuous until the middle of 1920 A very brief account of some of the causes of the great boom in trade and inflation of prices which followed the Armistice, and of the subsequent depression, has been given in the section dealing with the increase in bank deposits Wholesale prices at the end of 1918 were slightly more than double the pre-war prices, by the end of 1919 they were three times pre-war prices, and the increase continued until they reached their highest point in May, 1920, when prices, according to the new Board of Trade Index Number, stood at 332 6 compared with 100 in 1913 In August, 1920, they still stood at 320 0, but fell considerably during the second half of 1920 to 269.4 in December. The fall continued with great rapidity during 1921, and prices had dropped by May, 1921, to 204 7, or practically double the pre-war level.

until 1882 that a serious effort was made to organize elementary, technical and industrial instruction.

Great efforts have since been made to organize and extend technical, industrial, and commercial instruction in France. Unqualified success has deservedly crowned these efforts, and, as a result, technical and industrial instruction has been moulded into its three well-defined degrees corresponding to primary, secondary, and higher education. Primary technical instruction is given in the superior primary schools, including the Apprenticeship Schools and the three *Ecoles Nationales Professionnelles,* founded a few years ago by the State at Voiron, Armentières, and Vierzon. The primary schools are, in regard to the technical and industrial courses of the above institutions, merely preparatory. Secondary technical instruction is given in such special institutions as *Les Ecoles d'Arts et Métiers* at Aix, Chalons, and Angers. Higher technical instruction is given in such institutions as the Central School of Arts and Manufactures, and the *Institut Agronomique,* at Paris.

United States came in May, 1920 (as in the case of the United Kingdom), when the index number stood at 272 By December, 1920, prices had fallen to 189, and by May, 1921, to 151

Thus, whereas prices in the United Kingdom increased between 1913 and May, 1920, by 232 6 per cent , prices in the United States increased only 172 per cent By May, 1921, British prices had declined by 47 per cent and American prices by 44 per cent of the figures for 1920 Thus, between 1913 and May, 1921, the net rise of wholesale prices in England was greater than that in the United States

§ 7 Effects of the Changes in the Level of Prices upon Different Classes of the Population

It is not possible from the data at present available to make any reliable statistical estimates of the increases or decreases in the incomes of different classes of the population during the last seven years , moreover, the problem is complicated by the present very heavy burden of taxation

It is only possible to indicate certain classes who must have gained, while others as certainly must have suffered loss in the sense that their incomes have not increased as fast as the rise in the general level of prices.

In Cmd 594, the Board of Inland Revenue estimated that by June, 1919, the aggregate

increases in value of all individual items of property which had increased in value amounted to £5,525 m , while the net increase in value of the aggregate property of individuals amounted to about £4,000 m

It may safely be assumed that at the date of the above estimate the money incomes of the manufacturing and commercial classes had increased greatly

It should be noted that the slump in trade has had a great effect upon the industrial and trading community, who have been severely hit by the great decline in wholesale prices There can be no doubt that if a corresponding estimate were made now, the result would be widely different , though it must not be inferred that the present depression in prices and business incomes is more than temporary

It is difficult to make any definite statements so far as the general body of wage-earners is concerned

An attempt has been made in the *Labour Gazette* for February, 1921, to estimate the general changes in wages from July, 1914, to December, 1920 The broad conclusion reached is that, taking all the industries for which information was available to the Department—chiefly those in which wage rates were settled by organized bodies of employers and workpeople—the average increase up to the end of December, 1920, in the *weekly full time rates of wages* was equivalent to about 170 to 180 per cent. on the pre-war rates.

As there had been a considerable reduction during the same period in the normal number of hours worked per week, the percentage increase in hourly rates of wages would have been substantially greater. As the above rates are mainly in respect of organized industries, and there is a presumption that the wage increases in the unorganized industries were not so great as in the organized, it is possible that the increase of 170 to 180 per cent. may slightly exaggerate the true increase for all industries

The above estimate, however, only applies to rates of wages, and not to earnings By December, 1920, the effects of the slump in trade on employment had become very apparent, and there was a great deal of short time being worked as well as much unemployment. The *Labour Gazette* estimates that the percentage increase in actual *earnings* of employed people in July, 1920, over July, 1914, was 175 per cent., but by the end of 1920 the increase had fallen to 135 per cent, despite the fact that in a number of industries there had been an increase in the rates of wages between July and December, 1920

The index number of retail prices published in the *Labour Gazette* had risen by July, 1920, to 152 per cent. above 1914, and by December, 1920, to 169 per cent. above 1914.

There is some evidence, therefore, that by July, 1920, earnings had increased more than in proportion to the increase in retail prices, but that by December, 1920, the position had been reversed,

the increase in earnings since 1913 being less than the rise in retail prices

There can be little doubt that during the war, and the eighteen months succeeding the Armistice, when employment was good, when family earnings were frequently increased by the payment of separation allowances, and later by gratuities and high out-of-work pay for ex-Service men, and when large numbers of women had been drawn into industry, the family earnings of the wage-earning class as a whole were such as to represent a substantial improvement on their pre-war conditions, in spite of the rise in prices With the depression in trade, however, the whole complexion of affairs has been altered By May, 1921, the index number of retail prices had declined to 119 per cent above the pre-war level But wages had also fallen substantially in many industries, and the volume of unemployment, accentuated by the coal dispute, had risen to a level unprecedented in the thirty years' records of the Board of Trade

Farmers as a whole have, until recently, reaped great benefits from the rise in prices of all agricultural produce Rents have risen to some extent in most cases, but by no means in proportion to the increased profitability of farming The landowning class on the other hand are in receipt of incomes whose purchasing power is appreciably less than before the war

The effects of the rise in prices have been felt most severely by the great body of the

professional and salaried classes and by all those who have been in receipt of incomes from securities bearing a fixed rate of interest, or from pensions, etc There can be no doubt that in these cases there has been a definite transference of wealth to members of the other and more fortunate classes

Part II

THE SOCIAL EFFECTS OF A HIGHER OR LOWER PRICE LEVEL

§ 8 The preceding discussion has shown how greatly the general level of prices has been disturbed, and how arbitrarily the change has transferred wealth from one part of the community to another These changes indicated, there arises the fundamental question what price level is now desirable in the general interests of the community if society were free to establish the level of prices most conducive to its general welfare, what would this level be would it be higher or lower than the post-war level, and by how much ?

Before this question can be dealt with, a preliminary question must be answered · What is the post-war price level ?

Is it that reached during the recent period of boom when *The Times* index number recorded a rise in wholesale prices from 100 in 1913 to 329 in April, 1920 ; or is it the level, 40 per cent.

lower, reached during the subsequent depression, and recorded in April, 1921, as 189? The answer, no doubt, is that neither of these figures indicated what may properly be called the post-war level of prices. Periods of business activity, such as that of the early spring of 1920, are periods of high confidence in the immediate business outlook. This condition of confidence, by stimulating production, increases the volume of goods offered against money and so, taken by itself, tends to lower prices. But the same condition leads also to an expansion of cheque currency, of bills of exchange and of book debts and especially to a more intensive use of the various forms of purchasing power. And as the volume of *effective* purchasing power is expanded in greater proportion than that of the goods against which it is offered, the net effect is to drive prices upward beyond the level which may be vaguely conceived as that normal to the general circumstances. Opposite influences are at work in a time of depression, such as the spring of 1921. A general lack of confidence on the one hand leads to reduced output; on the other discourages investment and, reinforced by the expectation of lower prices, checks buying both by business men and the ultimate consumers. The volume of effective purchasing power contracts more greatly than the output of goods, and prices are driven below what may be regarded as the normal level. The alternations of confidence and pessimism, which are the central influence in alternations of business

activity and depression, cause therefore wide fluctuations in the volume of effective purchasing power and alternately drive the price level above and below that equilibrium point whose position is governed on the one hand by the volume of money and on the other by the volume of goods against which that money is offered It is therefore not the *current* price level, but rather this equilibrium position, this "*normal*" level of prices (a level corresponding roughly to the midway point between the highest and lowest price levels reached in the course of a business cycle), which must be borne in mind when considering whether or no it is in the general social interest that the level of prices should be raised or lowered

§ 9 At what figure an index number, taken as 100 pre-war, should stand in order to record this normal post-war level is a matter of the greatest difficulty to determine. On the side of the demand for money, business statistics, imperfect as they are, show conclusively that there is a substantial decline in the aggregate output of goods (cf p. 32). On the side of supply are banking and currency statistics. Between December, 1913, and the corresponding month of 1920 the deposits of the Joint Stock banks of the United Kingdom, according to *The Statist's* figures (cf. p 17), increased from £1,070 m. to £2,549 m, or in the proportion of 100 238, from which it may presumably be inferred that current account balances, the basis of the great bulk of the purchasing power of this country, also increased

to about 2½ times their pre-war volume Further, it is estimated (in Cmd 734) that between July, 1914, and March, 1920, the volume of "currency" in the United Kingdom (the volume of legal tender money, exclusive of gold held in the Issue Department of the Bank of England) increased in the ratio of 100 250, a proportionate increase corresponding very closely to that of bank deposits.

During the period of comparison there has been some increase in the use of money for purposes other than the purchase of goods, i e the demand for money has been increased by its temporary employment for such purposes as the payment of pensions and of interest on National Debt, but this change can hardly be one of appreciable importance It is possible, further, that heavy taxation and the greater uncertainty in the financial position of business men and private persons may lead to their normally holding a larger proportion of their money in the form of accumulations against tax payments and reserves against emergencies, with the result that, on the average, money is less actively employed or, in other words, that the increase in the volume of *effective* purchasing power is less than otherwise appears. But when some allowance has been made for such considerations, together with a margin for the conjectural nature of the estimates, it remains true that there has occurred a substantial fall in the volume of goods offered against money, and seems highly probable that there

has been an increase in the supply of effective purchasing power in a ratio not much less than 100 240 In these circumstances it is difficult to avoid the conclusion that the normal post-war level of wholesale prices, that is to say, the level which tends to establish itself when business is neither unduly active nor unduly depressed, is not lower than the level indicated by an index number of, say, 240, a figure substantially above that of 189 given by *The Times* for April, 1921

As all that is needed for the present argument is a rough indication of the normal post-war price level, this figure may be used for the purpose, and the question to be dealt with stated in the form is it in the interests of this country that its normal price level should remain at about 240, that it should rise above it, or that it should fall below it ?

The answer to this question depends on considerations which may be roughly separated into two groups first, the effects of a changed price level on the general well-being of society , second, its connexion with the question of a return to an effective gold standard As the disturbances to business arising in the course of transition from one level to another are most suitably discussed in connexion with the second group of considerations, it will be convenient to omit them when dealing with the former group and to confine that discussion mainly to a contrast between one price level and another, assuming the alternative level to have been established.

§ 10 The discussion may begin by an examination of the argument that inasmuch as the upward movement of prices inflicted great inequities on certain classes of the community, in particular those with small fixed incomes, that movement should now be reversed in order that these inequities may be redressed

Had the rise in prices been uniform throughout the whole field, had it affected the value of human services and goods at the same rate and in the same degree, it need not have caused any great social disturbance Its principal consequence would have been that the unit in which values are measured had been changed in the proportion of 24 to 10, incomes and market prices alike would be measured in terms of a unit whose purchasing power had fallen in the proportion which 20*s* bears to 8*s* 4*d* In fact, of course, a uniform rise of this kind was made impossible by the existence, among other things, of a very large volume of contracts whose conditions extended into the future Many people had supplied money at fixed rates of interest in exchange for a promise to repay a fixed sum at a later date, prominent among these were lenders against mortgages, debentures, preference shares, and in particular the earlier issues of war stocks. Many others had lent land, buildings and other property at fixed rents Others still had undertaken to supply personal services at rates of salary or wage which, for different reasons and in varying degrees, were not readily changeable.

As all these contracts, immense in their aggregate volume, were expressed in terms of the pound sterling, they were surreptitiously modified by the fall in the value of that unit, with the result that there were in effect very large transfers of wealth from those who had contracted to receive to those who had contracted to pay No doubt many of those who lost as debtors obtained some relief by being also creditors, many who earned salaries or wages found compensation in the exceptional opportunities opened up to them by the abnormal conditions of the time, subscribers to the earlier war loans were granted valuable conversion rights, and the rise in the rate of interest, though it involved a fall in the value of many securities, increased the yield on capital sums becoming available for reinvestment, and so gave some relief to those most hardly hit—clergy and other professional men, those retired from work and others dependent on small fixed incomes But when every allowance is made for compensating influences, it is obvious that the rising price level caused an arbitrary and inequitable abstraction of wealth from considerable numbers by whom it could ill be spared The injuries inflicted in this way should, it is argued, be redressed by initiating a corresponding fall in prices.

This argument can hardly be met by the contention that the real inequities of the war were not those which expressed themselves in the form of monetary loss, or by showing that

even greater unfairness was caused by such changes in the pressure of social needs as multiplied the profits of engineers and closed the yards of those so unfortunate as to be builders, or even by pointing out that the group on whom this injury mainly fell formed no large part of the community For a claim to redress cannot be met by the contention that greater evils remain unremedied But it may fairly be urged that the remedy proposed is not the right one, that a *general* change such as a reversal of the movement of prices is not well adapted to remedy an evil affecting a particular group, that such a remedy, by retracing the whole course of disturbing events, is likely to create more unfairness than it removes Indeed, it seems clear that if those who have been especially injured by the rise in prices are to be compensated, the remedy should be one whose effects are confined to redressing these particular injuries Even if such a remedy cannot be found, the claim to redress can hardly be held to justify any deliberate alteration of the price level, in view of the arbitrary modifications which such an alteration would introduce in the immense volume of time contracts entered into at levels of prices recently current

§ 11. But the social gain or loss resulting from a changed level of prices clearly cannot be determined simply on grounds of fairness. A further weighty consideration is the effect which a higher or lower price level would have on State

finance through its modification of that very important group of contracts which constitute the National Debt That this effect may be traced the more clearly it will be well to recall the main facts with regard to the debt and the principal difficulties to which its existence already gives rise It will then be possible to consider the manner in which a change in price level would accentuate or relieve these difficulties

According to Mr. Chamberlain's budget speech, as reported in *The Times* of April 26, 1921

Our total dead-weight debt at the end of March, 1921, was, in round figures	£7,600 m
Included in this figure were Treasury bills and Ways and Means advances of	£1,275 m
And debts to other countries of about	£1,160 m

In consequence of this condition the Chancellor is obliged during the current financial year to make provision for the following additional payments —

Interest on internal debt, about	£320 m
Provision for depreciation and sinking funds and for stocks tendered in payment of taxes	£113 m
To meet foreign debt .	£80 m
To meet Exchequer bonds falling due	£114 m
To meet Exchequer and War bonds maturing early in next financial year	£ -
Giving a minimum total of some .	£630 m

What he has actually done has, of course, been based on estimates of the general outlook at the end of April last. After making allowances for

a settlement of State liabilities to the railways, for the effects of the business depression and for those of the stoppage of coal production, then in its fourth week, he has provided for a revenue, ordinary and extraordinary, estimated to yield some £440 m. available for the purposes described in the preceding table The balance he proposes to meet by a renewal of internal debt It is hardly relevant to the present argument to consider the extent to which subsequent events may have falsified these estimates The questions to be dealt with are, first, the nature of the difficulties which arise from the existence of this debt, and from the consequent necessity to raise some £440 m. of additional revenue and a further sum of uncertain amount by way of loan. And secondly, whether these difficulties form any justification for an attempt to raise or lower the general level of prices.

There is one common influence exerted by each part of our debt No country could become liable for a debt of £7,600 m. without suffering some injury to its credit, some weakening of its power to borrow abroad in times of emergency, or at home for such purposes as the renewal of maturing loans. A condition of heavy indebtedness, therefore, lessens the financial security of a country in much the same way as mistrust by his banker weakens the financial position of a business man; in so far as new loans are concerned, this injury is measured by the need to pay a higher rate of interest than would otherwise be

sufficient to obtain resources from the home or foreign investor. Apart from this general influence, each separate part of the debt has its own peculiar effects, which need separate consideration.

§ 12 FOREIGN DEBT

The figure of £1,160 m quoted above does not, of course, include that part of our "internal debt" which may be held abroad It is calculated not at current rates, but at the par of exchange and is composed mainly of the sum of £973 m due to the United States, the residue being made up of £53 m due to Canada, £8 m to the Straits Settlements and Mauritius, a small sum to Sweden and an amount of £126 m, being "loans from certain Allied Governments which may be regarded as available to be set off against debts owed by the same Governments to this country"

As a partial set-off we are owed £144 m by the Dominions and £1,804 m by our Allies (including Russia), a total of some £1,950 m On the great bulk of these two sets of debts interest is neither paid nor received. In March last the accumulated interest on our debt to the United States (not included in the figure of £1,160 m.) amounted to some £65 m ; in June it was vaguely and perhaps inaccurately reported that a provisional agreement had been reached whereby interest payments would be postponed for fifteen years. Nevertheless, in the last financial year the principal of our foreign debt was reduced by £117 m., and

provision is made in the current year for a further reduction of £80 m

The service of our foreign debt requires, therefore, that during the current financial year the real incomes of people of this country shall be reduced by a quantity of goods and services valued at £80 m , which is handed over to foreign countries Further, the pressure of demand for the foreign currencies (the financial counterpart of this operation) tends to depress the international value of the pound sterling and so to affect unfavourably the real cost of our imports Can this burden be lightened by a change of price level in this country ? If such a change had no effect on the foreign exchanges the answer would clearly be in the affirmative. For the higher the home price level, the less is the quantity of goods and services required to make up the value of £80 m , and the less consequently would be the real burden to this country of paying off a given quantity of the dollars in terms of which the bulk of our foreign obligations are expressed But the supposition is not justified It seems fair to say that, according to the best opinion, a rise in the home price level, in other words, a fall in the home value of the pound sterling, would be reflected in a roughly proportionate fall in the value of the pound in terms of dollars , though, of course, this effect on the foreign exchanges might be concealed by other influences operating at the same time In so far as the effect of a change in the home price level is in this way

cancelled by its effect on the foreign exchanges, it is clear that no such change can affect the real burden to this country which is involved in repayment of its foreign debt

But this is not all We are owed by the Dominions and our Allies (including Russia) a sum of nearly £2,000 m As these loan contracts are expressed (mainly, if not wholly) in terms of English pounds sterling, their real force depends on the purchasing power of the English pound, the higher the price level of the United Kingdom, the less the real force of the debts, the lower the home price level, the larger the amount of real things we are entitled to receive from our debtors [1] In the purely material interests of this country, these considerations might form an argument for a lower price level But that argument is a poor one, for it is clear that the amount we shall ultimately receive in redemption of this debt, or in payment of interest upon it, will be determined, not by the level of prices in this country, but by the general political and economic condition of Europe The conclusion, then, may perhaps be put in this form that in so far as changes in the home price level are reflected in the level of the foreign exchanges, they have no influence on the real burden of our net foreign

[1] This argument apparently does not apply to reparations payments, but it applies to that part of our pre-war foreign investments still outstanding, which is represented by securities expressed in pounds sterling and bearing a fixed rate of interest.

debt, except in so far as a fall in the home level of prices might increase the burden of the debt due to us from the Dominions and our Allies—a result which no one in this country would deliberately seek to bring about

§ 13 SHORT-TERM HOME DEBT.

The chief evil of a condition in which some £1,209 m of our internal debt is in the form of Treasury bills and Ways and Means advances seems to lie in the dependence of the Government on the Market for the continuous renewal of its maturing obligations This dependence, together with the need of the State to make immense periodical payments for interest and so on, is continually compelling the Government to meet temporary excesses of expenditure over revenue by borrowing from the Bank of England, sometimes to the extent of £50 m in a single week The alternate creation and extinction of these loans causes marked fluctuations in the supplies available in the short loan market, and consequently wide variations in rates, which add appreciably to the risks of business

Further, it seems only reasonable to assume that the current difficulties of renewal will be accentuated when a revival of trade tends to divert a larger share of the banks' resources to the discount of commercial bills and the extension of loans requisite to give scope to the development of business. In such circumstances, it would seem, the Government will be compelled to

make a choice between two evils. On the one hand with the taxpayer at its back, it could outbid business men by raising its Treasury bill rates (a change presumably followed by a rise in Bank rate), in that way renewing its maturities by drawing to itself money otherwise available for commercial uses Alternatively, it could refrain from raising Treasury bill rates to any considerable extent and make good its deficit by becoming a large and continuous borrower at the Bank of England Such a policy, by encouraging a large extension of bank loans and consequently of cheque currency, could hardly fail to cause a greatly increased demand for legal tender money, with the result that the Treasury would find it difficult, if not impossible, to maintain its policy of limiting the fiduciary issue of Treasury notes This latter method of meeting the difficulties arising from the existence of an immense floating debt depends, therefore, on an expansion of the currency and a consequent rise in prices. It illustrates the consideration, which is discussed from a different point of view, in the following paragraphs, that the difficulties arising from the internal debt may be alleviated by a rise in the general level of prices.

§ 14 INTERNAL DEBT

The outstanding difference between foreign and home debt is clearly that in the one case the proceeds of the taxes levied for the service of the debt are handed over to foreigners, while in the

other they are handed to citizens of the home country. But although internal debt involves only a transfer of wealth within the country from the community in general to stockholders in particular, the cost of the State machinery by which this transfer is carried out and the effects on the community of the compulsory collection of very large annual sums constitute a definite social evil

In § 11 it was shown that as a consequence of the existence of our total debt, home and foreign, the Chancellor was endeavouring to raise in the current financial year some £440 m over and above the revenue required to meet the costs of military and civil services As that figure is about the same as the estimated revenue from Income- and Super-tax (£410 m), the real social costs of effecting the transfer of this sum from Income-and Super- tax payers to the holders of Government securities may be taken as a rough measure of the remaining social burden due to the existence of our immense National Debt.

In practice, of course, the abolition of the debt would involve a reduction of taxes generally, but it seems reasonable to assume that the relief afforded by such a reduction would be fairly well represented by that resulting from the abolition of taxes on income.

The actual costs of administration in collecting some £400 m. per annum, amounting to a few million pounds yearly, are a comparatively minor

matter. More important perhaps is the fact that these taxes, being compulsory levies based on rigid standards, inevitably press at many points with undue weight, so that resources requisite to maintain efficiency and develop material equipment are compulsorily withdrawn at a heavy social cost Of greater importance still is the consideration that these taxes, increasing as they do with the size of incomes, necessarily increase also with the amount of productive effort put forth by those who earn those incomes Granted that one of the greatest incentives to business enterprise is the desire for success, it remains true that very heavy taxes on income must inevitably operate in a similar direction, though not perhaps with similar force, to the Excess Profits duty , and there is general agreement that that duty pressed heavily on the sources of enterprise and saving It would involve too lengthy a discussion to attempt to form an estimate of the net social injury involved in the collection of these heavy taxes It must be sufficient to put the question whether a business man who is earning, say, £9,000 a year and is contemplating an extension which is estimated to yield additional profits of £1,000 per annum would not be less inclined to devote time and labour to this expansion of his business from knowing that if this additional profit is actually realized he will be required to pay over £550 of it to the State

No one is likely to deny that the service of

the debt, even though it may involve only a transfer of wealth, *via* the State, from one set of persons to another, involves also real social costs The difficulty is to estimate the true importance of these costs. Whatever their amount they would clearly be increased by a fall in the level of prices due to monetary causes, for such a fall would increase proportionately the share of the total real output of the country which was collected from the taxpayer and transferred to stockholders Conversely, a rise in the level of prices would alleviate this burden , for average money incomes being higher, the collection of a fixed sum for the service of the debt would be less felt by those from whom it was compulsorily taken On these grounds, therefore, a tolerably strong case can be made out in favour of a higher level of prices

§ 15 From these various and conflicting considerations an answer has to be found to the question does our condition of indebtedness make it desirable in the general social interest that the future price level should be above or below that which may be regarded as the post-war equilibrium ?

The answer can only be an uncertain one. Considerations of fairness show that a rise in prices would increase the injury suffered during the war by owners of small fixed incomes and would, further, arbitrarily modify contracts entered into at levels of prices recently current. Such a rise would probably have little real effect on the net

burden of our foreign debt. On the other hand, a rise of price level would materially reduce the social burden which results from the necessity of transferring annually large sums from one group of people to another within the community. It remains to be seen how this conclusion is modified by the following discussion dealing with the business disturbances accompanying the transition from one price level to another and the desirability of returning as soon as possible to an effective gold standard

Part III

THE RESTORATION OF A GOLD STANDARD

§ 16 As indicated in § 15, the question of the direct effects of a changed price level on the general well-being of society cannot be considered entirely in isolation It must be considered also in connexion with the view that efforts should be made to restore an effective gold standard in this country at the earliest possible date. The first stage in the discussion must be a brief inquiry into the merits of this view, which though widely held and expressed is by no means self-evident

The general objection to regarding gold as a satisfactory standard of value may be developed as follows. First, there is no universal agreement about the way in which, if the matter lay perfectly within our own control, we should wish our standard of value to behave, secondly, whatever our wishes, there is no security that a gold standard will procure their fulfilment

As regards the first point, most people, it is true, would probably be ready to endorse the common-sense view that the level of prices

should be kept as stable as possible. But a strong case can be made out for the rival opinion that in times when inventions in technique and organization are persistently increasing the productive power of the community the price level should suffer such a continuous fall as automatically to give those with fixed money incomes a fair share in the fruits of man's increased mastery over Nature, while in times of dearth or devastation or retrogression the price level should suffer such a rise as to inflict automatically on those with fixed money incomes their share of the real burden to be borne And a case less strong but by no means negligible can be made out for a third opinion—that under a system of private enterprise a gentle but continuous rise in the price level would in fact produce the best results, because it would afford a continuous stimulus to enterprise, production and employment

But secondly, whatever view about the proper behaviour of the price level be adjudged correct, there is no good prospect that the restoration of a gold standard would result in that view being translated into action. The price history of the century before the war affords abundant evidence that the gold standard has neither kept the price level stable, nor—except temporarily and by accident—forced it to follow any other reasonable course. Nor are there grounds for greater optimism with regard to the future. A country which ties itself to a gold standard puts itself at the mercy not only of changes in the sources

and technique of gold production, but also of changes in the monetary institutions of its neighbours There are few people who would care to predict with confidence either the future course of the world's output of gold, or the number and importance of the countries which will eventually re-establish a gold standard, or the precise extent to which even those countries will economize the use and multiply the effectiveness of their gold holdings by retaining and perfecting the use of paper instruments of payment The behaviour of the price level under a restored gold standard is therefore difficult to foresee, and may not impossibly prove to be unfavourable either to industrial progress or to social stability

§ 17 These considerations may well forbid the display of any extravagant enthusiasm in advocating the restoration of an effective gold standard. Nevertheless, it is still possible to hold that such a restoration is, in all the circumstances, the most reasonable object at which to aim in the moderately near future. Support for this opinion can be found in two solid if uninspiring arguments, the one of a general character, the other more particularly concerned with international trade. The first is based on the acknowledged difficulty of operating any other standard with even moderate success. The prime duty of those—whether Governments or bankers—who are responsible for the manufacture of the instruments of payment should be to adjust the supply of these instruments to the

work which they have to do in such a way as to carry out consistently a reasonable and intelligible policy with regard to the level of prices It is not disputed that, given sufficient knowledge and determination, this *might* be done more effectively with an inconvertible paper standard than with a gold standard , but it is legitimate to doubt whether, in fact, it *would* be done The propensity of Governments to expand unduly the manufacture of the instruments of payment has become a commonplace of economic discussion it is still not so usual to find a frank recognition of the fact that the immediate interests of the business world, and even of the bankers themselves, exert a constant pressure in the same direction The duty of preserving a gold standard imposes some check, even though a rough and arbitrary one, on these dangerous forces , and though it introduces dislocatory influences of its own, they are likely on the whole to be less violent and subversive than those which it thus assists to keep under control

Secondly, especially for a country so dependent as our own on the operations of international commerce, the maintenance of stability in the foreign exchanges is an object of prime importance. The method by which this was accomplished under the old universal gold standard is well known , and it can be pointed out that a number of countries with which we have important business dealings are either (like the United States) already on a gold standard, or would

(like the British Dominions) be likely to attain one more or less concurrently with ourselves The strength of this argument for returning to a gold basis depends partly, it is true, on the extent to which the other lately belligerent countries could be relied upon to follow our example, and once more it must be emphasized that the stability of the exchanges *might* be re-established by other methods than the restoration of a gold standard But there is no method so generally understood, and perhaps none which is so likely in fact to be aimed at by any country which is making a sustained endeavour to achieve monetary stability.

§ 18 For these reasons the restoration of an effective gold standard may fairly be regarded, not indeed as a royal road to economic prosperity, or a final goal of monetary policy, but as a respectable interim measure the accomplishment of which would be worth some trouble and inconvenience But such a conclusion must remain a mere pious opinion unless it can be followed up by some indication of how this result is to be achieved in practice · and it is here that the real difficulties begin

The first proposition to be emphasized is that the restoration of an effective gold standard in this country at the old par of exchange is contingent, not on the establishment of any particular *absolute* price level in this country, but on a modification of the *relation* between the price level in this country and the price level in gold

standard countries—that is, for practical purposes, in the United States. The argument can best be developed by neglecting for the moment the occurrence of business fluctuations, and concentrating attention on the "normal" post-war equilibrium price levels, in the sense in which that phrase was used in § 8 If the figure of 240 (as compared with pre-war 100) be accepted for this country, a corresponding figure of, say, 180 may perhaps be hazarded for the United States It is clear that so long as this relation prevails, it would be impossible to maintain an effective gold standard in this country at the pre-war par of exchange The assumption by the Government or the Bank of England of an obligation to provide unlimited gold for export, at the old rate, would afford such a prodigious and sustained stimulus to the importation of goods from the United States and the exportation of gold from England that the obligation could not for long be discharged Neither a declared willingness to restore the old gold standard, nor even the accumulation of large gold reserves with that object in view, could ultimately be of the least effect unless accompanied by a relative fall of some twenty to twenty-five per cent. in the "normal" price level in England as compared with that in the United States.

The next stage is to inquire whether general conditions can be relied upon to bring about this readjustment of the relative price level, without the adoption of any deliberate line of policy on

our part The answer to this question clearly depends on the future course of the "normal" American—that is of the "normal" gold—price level, and is thus, as already indicated, a matter for speculation rather than for reasoned prediction But it is permissible to call attention to several current tendencies which have some bearing on the matter First, the influence of the great pre-war expansion in gold production in driving up world prices has been modified by a marked decline in recent years in the annual output of gold, notably from the Transvaal mines Secondly, while many European countries have greatly increased their central gold reserves since 1914, largely by the absorption of gold from public circulation, it seems likely that they will retain for the present a strong desire, whether or no they develop the effective power, to increase them still further Thirdly, the average annual world output of commodities in general is likely, or so it must be hoped, to be greater in the future than it has been in the recent period of stress and dislocation Fourthly, up to the present at any rate, the set of American policy has been in the direction of strengthening the proportion of gold reserves to paper instruments of payment—in the direction, that is to say, of setting somewhat rigid bounds to the effective purchasing power generated by any given quantity of gold

It is difficult to estimate the strength or permanence of such forces as these: but in any

case the general conditions seem to be such that we cannot confidently count on a persistent rise in the general level of gold prices, which, expressing itself practically in a persistent fall in the purchasing power of the gold dollar, would gradually raise the rate of exchange on New York to the pre-war parity and automatically solve the problem of the restoration of a gold standard. That problem must therefore be solved, if at all, by deliberate action.

§ 19 In considering what form that action might take, it is convenient to deal first with an attractive proposal which has not failed to find support.

The restoration of an effective gold standard and the restoration of the pre-war gold parity are not synonymous terms. If the pound sterling were to be given by law a value in terms of gold equal to about four-fifths of that which it possessed before the war, a gold standard could probably be restored forthwith and maintained in effective operation Whether such a procedure would involve a breach of faith is a question of economic ethics, or perhaps of economic casuistry, which might in certain circumstances require careful and dispassionate discussion. It is, at any rate, tolerably clear that it is only by such an open "devaluation" of their standard currencies that the more important European Governments can ever now expect to re-establish a gold standard and it is arguable that this necessity would be rendered more palatable to them, and the return to economic stability desirably hastened, if

such a comparatively prosperous and respectable Government as our own were to show the way.

But it is also clear that a policy of this kind cannot in actual life be based solely on considerations of its inherent fairness and reasonableness. It is essential to take into account the opinion which the business world would, in fact, form of the proposal, and the effect of that opinion on the financial well-being of the country Within the country there would certainly be acrimonious criticism , and that criticism would be re-echoed by the foreign holders of sterling securities and balances, with results which might be damaging to the prestige of what is still the leading financial centre of the world. If the necessity for an immediate return to a gold standard were really pressing and paramount, these consequences might have to be faced But the objections indicated seem sufficient to justify the rejection of the proposal except as a last resort.

§ 20. The next alternative to consider is the adoption of a monetary policy designed, by lowering the level of prices in this country, to establish the desired relation between the English and the American price levels. The disadvantages of such a deliberately lowered level of prices have already been discussed in §§ 10–15. They comprise the upsetting of established contracts and expectations, and the increasing of the burden of the National Debt , and they should be sufficient to give pause even to those who take a more enthusiastic view of the blessings of a gold

standard than has been expressed above But before attempting to form a final judgment it is necessary to take into full account the complicating circumstance hitherto deliberately ignored—namely the occurrence of those business fluctuations whose nature has been briefly described in § 8 For the phenomenon of business fluctuation in some ways weakens and in others strengthens the arguments for an early and strenuous attempt to restore the old gold standard.

On the one hand, the course of business fluctuations furnishes a reminder that whatever the comparative merits of a high and a low price level *when once established*, the process of substantially *lowering* the price level inflicts serious damage upon industrial activity and social welfare There seems no good ground for disputing the *prima facie* view that falling prices discourage the placing of contracts and the expansion of manufacturing capacity, depress the energies of business leadership, restrict the field for the employment of labour, and precipitate the occurrence of wage conflicts Nor do these direct and immediate effects complete the indictment for public opinion is probably substantially right in fastening upon the insecurity of employment as one, and perhaps the most important, of the root causes of the deep-seated maladies commonly described as "restriction of output" and "labour unrest." If economic stability can possibly be attained in any other way, he must be a bold man who, in view of the dislocation

and distress of the past twelve months, still advocates its attainment for choice by the method of a contrived fall in the price level Business fluctuations are not wholly monetary in origin, and are not therefore susceptible of a purely monetary cure but a monetary policy which aims at deliberately aggravating a business depression, even with the best of ends in view, is open to grave suspicion

§ 21 On the other hand, the fact that the "normal" price level is an abstraction, and that the actual price level is periodically carried far below and far above it, suggests another attractive alternative to the policy of a contrived fall in prices

It seems tolerably clear that in consequence of the present business depression the current level of gold prices is considerably below that "normal" level which is determined on the one hand by the output of goods and on the other by the supply of gold and gold substitutes offered against those goods As this depression passes, therefore, it seems reasonable to expect a substantial rise in the gold price level, which, *if it were confined to the gold price level,* would be shown in a fall in the purchasing power of the dollar relatively to the pound sterling, and a consequent tendency towards a rise in the dollar-value of the pound

But we may not assume that the rise would be limited to gold prices It is clearly more probable that as this country also emerges from the

present business depression, there will, with the aid of the unused margin of £40 m in the fiduciary issue of Treasury notes, be a substantial expansion in the effective supplies of purchasing power, with the result that sterling prices will rise as dollar prices rise, and leave us in no better case than before. If, however, at such a time the Treasury and the banks adopted a resolute policy of moderating the expansion of the home currency, and so restraining the rise in sterling prices within modest bounds, the gap between the American and the English price levels would, for the time being, be at least partially closed

It is not expected that we should be able to take advantage of this phase to restore the gold standard forthwith. If we did so, and if we were able to maintain that standard in operation, it would mean that in the subsequent depression English prices would probably share to the full the fall of prices in the United States. In that case, it might be difficult to rebut the accusation that we had deprived the business community of the full effects of the boom only to involve it in the full effects of the slump, and that we were, in fact, adopting in a roundabout manner the policy condemned in the last section—the policy of unnecessarily aggravating a depression under the influence of the lure of the gold standard.

It seems much more likely that, during the phase when the gap between the American and English price levels was partially or wholly closed, it would not be thought to be a wise

policy to attempt to re-establish the gold standard. In that case, our hope and expectation might be that the ensuing fall in home prices would, like the preceding rise, be of moderate extent Even this result would, it is true, entail disadvantages of its own, for it would mean that we should be obliged to watch the partially closed gap between the English and American price levels widening once more—in other words, to put up with an additional cause of instability, as between times of boom and depression, in the New York exchange, though not necessarily in those with other countries. The New York exchange is no doubt far from stable at present but it is one of the prime objects of the restoration of a gold standard to make it so, and to introduce, in our quest for stability, an additional source of instability into the vagaries of the New York exchange would be a somewhat paradoxical proceeding

Nevertheless, there is no doubt that the policy of restraining the boom *would* bring the normal English price level more nearly into harmony with the normal gold price level, and would thus render it easier to take advantage of any opportunity for restoring the old gold standard which might in the future present itself. Further, such a policy of restraining the boom, while it would no doubt be resented by business men engaged in manufacture and commerce, has much to recommend it on general grounds. It would be fair, for it would check that modification of current contracts which is caused by rising prices;

it would not increase the present burden of our National Debt, and it would reduce the probabilities of our repeating the fantastic extravagances of the boom period of 1919–20. The recent reductions of the Bank rate can be heartily approved as a much-needed stimulant to trade, but a very different policy will be called for at a later stage.

How vigorously this policy will in fact be pursued depends on many conditions which it would be foolish to attempt to evaluate. We do not know how great would be the pressure on the banks for increased loans during a period of growing business activity. Neither can we forecast the extent to which our immense short-period debt and uncertain national revenue may compel the Government to expand the currency by borrowing from the Bank of England. Nor, again, can we do more than guess whether the banking policy of the Federal Reserve Board will encourage or restrict a substantial rise of gold prices in the United States. When such uncertainties as these are present it is of little use to look far ahead or to form any detailed plan of action.

§ 22. The general conclusion seems to be as follows. The restoration of the old gold standard is not the final goal of monetary policy, nor does it seem to be an object worth immediate and fanatical pursuit out of sheer *amour-propre*, or in the interests of a limited section, or at the cost of social disorder and distress. But it is

for this country a legitimate ambition, and an opportunity might arise for its fulfilment without the sacrifice of more important considerations In any case, a policy of restraining the advance of prices during boom periods is to be strongly advocated, both for its direct effects on social well-being, and because it may ultimately assist us in restoring a gold standard, if in years to come that should still prove to be the most desirable end of monetary policy

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